DOW THEORY LETTERS INC.

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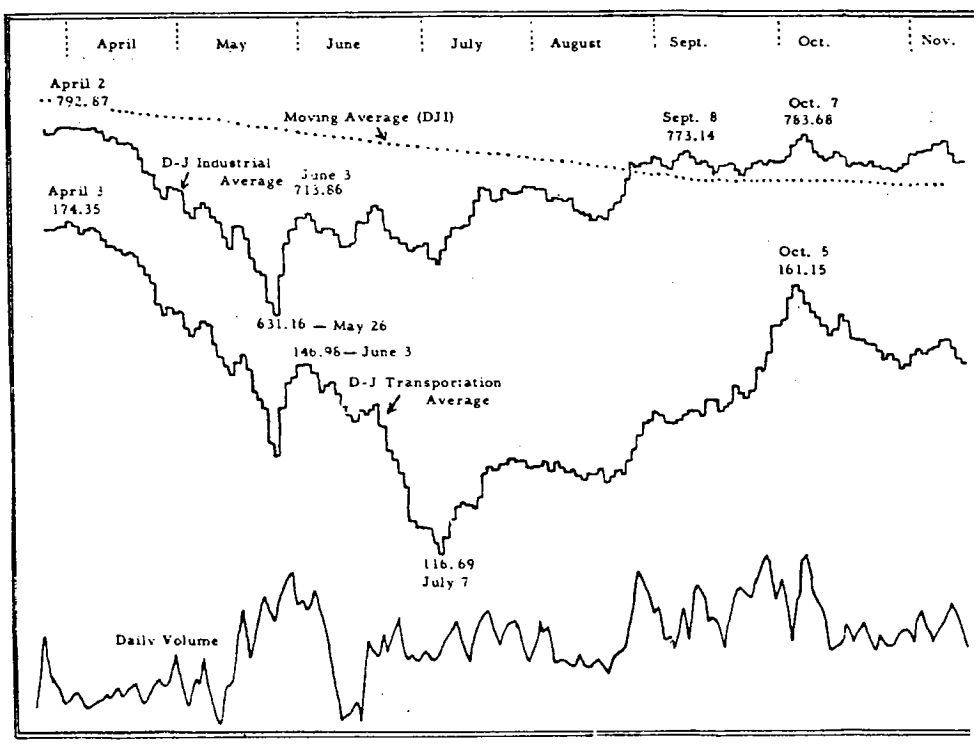
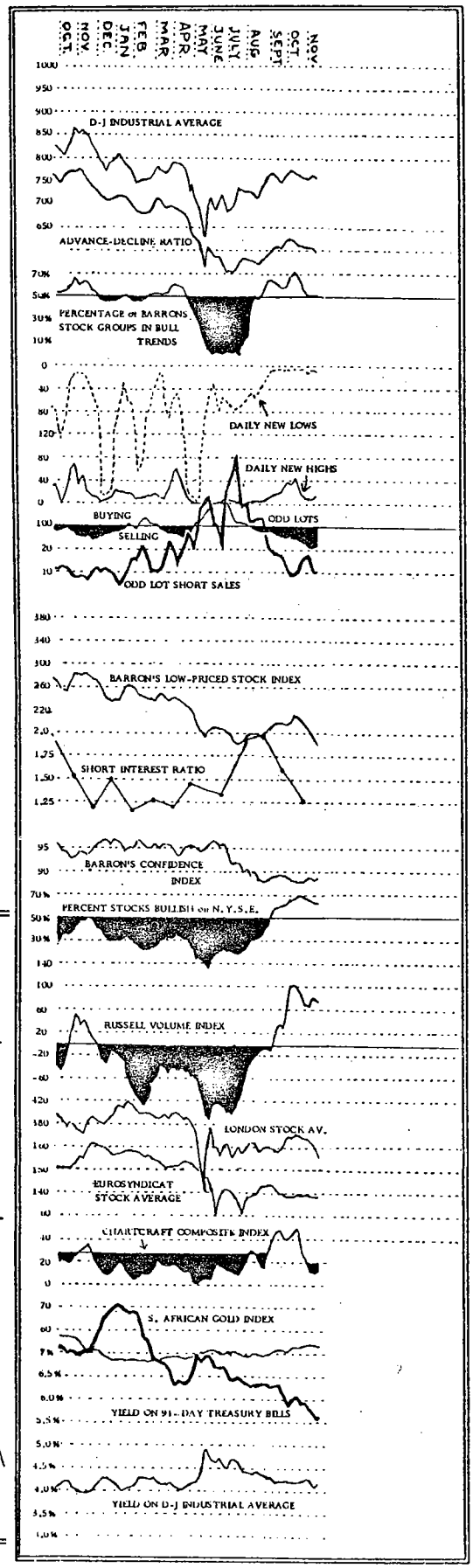
THE PICTURE: On the same day all the "good news" emerged: The Federal Reserve Board came through with a token 1/4% reduction in the discount rate (now down to 5.75%), and the GM strike (subject to union ratification) ended. The bellwether settlement, to my mind, was both ominous and highly inflationary. It amounted to a 30% wage and benefits increase over the next three years with 14% of the rise effective the first year. That 30% settlement will be the theoretical floor for all the other wage negotiations coming up in 1971.

The whopping boost in wages and extras comes at a time when the auto industry is locked in combat with foreign competition, it comes at a time when the industry is putting out mini-cars which bring far lower profits than regular sized cars (while also using less in materials), and it comes at a time when auto sales are not of record-breaking proportions anyway. Will the public swallow the increased costs which must come out of this contract? Will GM profits survive the increased costs, some of which will have to be absorbed by this contract? I rather doubt it. But time will tell. At any rate, I find the GM settlement something which I hardly feel like celebrating. America's bellwether corporation has decided to sign the greatest wage boost (and extras) package in auto history.

And the stock market, howis the stock market dealing with the giant greed being generated by America's corporations and America's labor? Underneath it all, underneath the wage boosts and the price rises, underneath the stock market rally which began on May 26, 1970, the bear still lives. And as in all corrective rises within a bear market, the investment fraternity is now indulging in a great spate of wishful thinking, vain hopes and misplaced optimism. The bear, exhausted after his onslaught of 1969-70, has been resting and gathering his strength. He has caught his breath, and is waiting to emerge again. And the trend of events are shaping themselves very much to the bear's liking. The





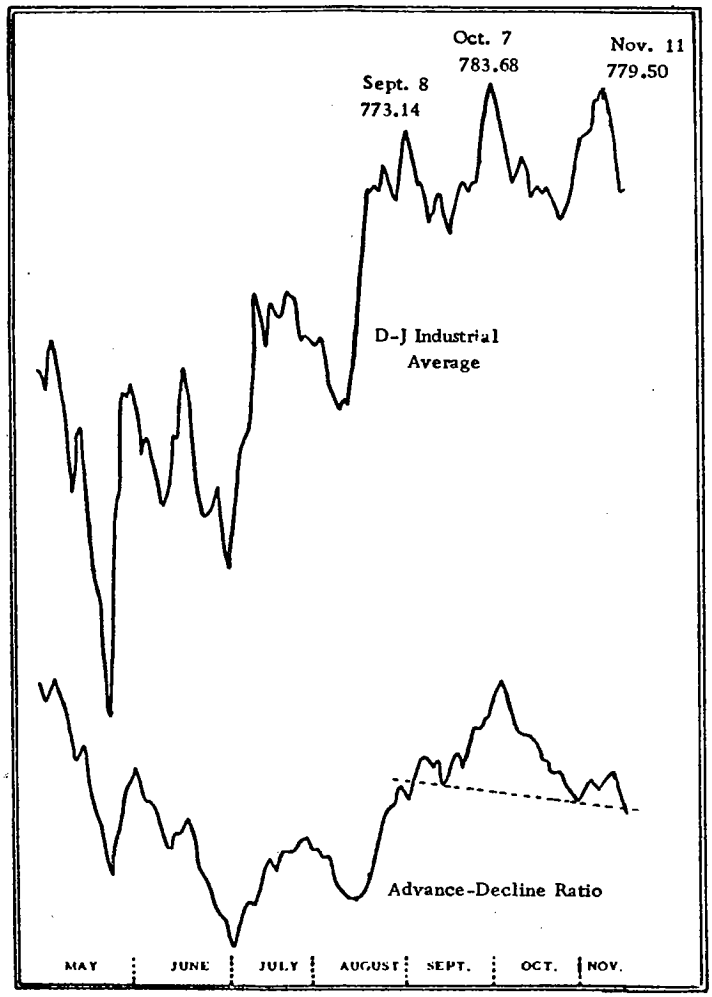
longer the market rally lasts, the greater the rest he gets, and the stronger grows the bear.

A hint of the underlying bearish power was provided on November , the day after the strike settlement. After opening up almost 9 points in the first hour, the Dow sold off steadily to close at a net gain of 2. 12. On November 12 the Dow started sinking, and by the close it was down 11.50 points, with the Transports and the advance-decline ratio almost at the bottom of their October-November range.

A glance at the accompanying chart will show that the Dow Industrials have made three upward stabs since September, terminating in the September 8 peak of 773. 13, the October 7 peak of 783. 68 and the November 11 peak of 179.50. Meanwhile, the A-D ratio has traced out an ominously "toppy" formation, and as I stated in the last Letter, it appears to me that regardless of one more possible run-up in the Dow (even to a new recovery high), the A-D ratio and the majority of stocks on the N.Y.S.E. have seen their best for this upward correction.

* * * *

Dun's magazine (November) carried an ominous account on the Business council's fall meeting. That meeting was underscored by "criticism" on the part of businessmen which "surprised Kennedy and McCracken". Said D.C. Burnham, Westinghouse's chairman, "Make no mistake, there is going to be continued pressure on profits. Unit labor costs are going to go up regardless of Washington's fiscal and monetary policies." Businessmen told Dun's that they didn't how the GM strike settlement could be anything but inflation-y, and further that they felt the GM settlement would simply become "a floor" for next year's negotiations.



Meanwhile, the United Steel Workers are already in the wings preparing for whopping wage boosts in the can, aluminum and steel industries. President Abel has promised his 750, 000 workers "the fattest settlement ever," and few doubt that he means to have a try at just that.

Now all this means one thing — inflation. At least it means inflation of wages, even while corporations are reeling from diminshing profits due to rising costs (see news clip). Those crumbling profits are going to mean crumbling tax receipts for the Treasury. At least one economist, my friend Eliot Janeway, recognizes the danger in the situation. "Even in a big Treasury deficit year," writes Janeway, "the Treasury expects to be comfortably in the black in March and April. March and April of 1971 will bring the first spring since the onset of the bear market in which the Treasury will be embarrassed by the short fall in collection now feeding on itself".

The prospects: Mountainous new deficits, definitely higher taxes and probably both. Such are the stuff of which bear markets feed. On top of this, Mr. Burns of the Fed is proving no Administration lackey. To the Administration's consternation, Mr. Burns actually seems very concerned about the balance-of-payments, rather than unemployment. The Administration feels that a steady rise of 7 to 8% in the money supply for about a year would be necessary to bring the unemployment rate down, but Mr. Burns prefers the current slightly-better-than 5% increase in the money supply. Prognosis: Continued higher unemployment with inflation. And the bear market may even have a nasty trick of its own up its sleeve. In the advent of another market collapse, capital spending would recede further, unemployment would rise further, profits would umble at an accelerating rate, and (as profits and national income declined) the Government x receipts would fade even further, bringing on a deficit the likes of which this nation has never seen before.

Meanwhile, as business expansion declines, as the need for money and credit eases, interest rates are coming down and foreign loans are being paid off. This means a new pile-up of dollars in foreign central banks — at a time when dollars are coming out of foreigners' ears.

Rising Profits Trend Broken, Survey Shows

NEW YORK (AP) — More than 24 per cent of America's 737 leading corporations are showing a downtrend in their five-year patterns earnings growth, a financial relations consultant said yesterday.

"For many of America's most highly regarded corporations, earnings growth peaked out well before the stock market downturn, and there are indications that 1971 will increase the number of companies showing negative earnings growth," said Robert Laffan.

Laffan said he based his observations on a computerized survey he made.

"The startling fact is that the 737 companies used in he survey comprise the most successful segment of American industry; if hundreds of companies with earnings records of lesser quality were included, the results would be even more dismal," he said in a report.

Those unwanted dollars represent claims on what is left of U.S. gold, and I wonder how long those claims can be held off.

Europeans are not unmindful of the U.S. predicament and the Administration's desperate "need" for a rising economy and full employment by 1972 election time. On November 11 the Wall Street Journal reported that Europeans are becoming anguished at the Administration's plans for "reinflating" the economy. "A high official of the European Economic Community" stated that any attempt to reach full employment by 1972 "would mean accepting a big rate of inflation and a big balance-of-payment deficit." The same official told a group of reporters that he would have "no objection" to this if it leads to a large dollar devaluation, not of say 20% but a full doubling of the price of gold.

It's a precarious situation, and I have said many times before, it's one thing putting the brakes on a car going 30 miles per hour, quite another thing slowing down a car that is careening down the road at 110 M.P.H. The U.S. economy has been smashing all speed records for years, and at this point no one knows how to apply the brakes. But they will be applied, and that painful process will probably take place (voluntarily or otherwise) during 1971 and 1972.

SHAPE OF THINGS TO COME: It is impossible for any single man to keep track of all the economic statistics or the significance of those statistics. I am exceedingly lucky to have many brilliant subscribers and correspondents such as Mr. Irving Weiss of Capital Advisors (New York), Mr. Eliot Janeway of New York, Mr. C. Coleman Petty of Louisville and Mr. Robert Scolnick of Canada, all of whom supply me with invaluable data and information.

For instance, Weiss notes in his latest report that during 1969 his estimate of business credit increase in the U.S. (including bank loans, mortgages, corporate debt, trade credit and commercial paper) was about $110 billion. Since the great bull market was financed on increases in credit (debt), it is crucial to note that Weiss estimates the credit increase for 1970 to be about $67 billion. This represents a drop of 39% from 1969. With the current collapse in the great credit pyramid, the U.S. boom appears to be tottering preparatory to a major collapse.

Mr. Scolnick also has a way with figures. Here are some of the series he is looking at. Unemployment in September, 1970 was 4.6 million, up from 4.2 million in August and up from 2.8 million in August, 1969. Meanwhile, employment has dropped from 80.2 million in July, 1970 to 78.2 million in September. Average hours worked during the same period has declined from 40.1 per week to 39.4 while overtime has receded from 3.0 to 2.7. All this means that the consumer is going to spend less, and in fact he has less to spend. Real spendable income per week dropped from $79.27 in September, 1969 to $77.68 in September, 1970. In other words, if the bulls are looking for the consumer to hold up this economy, they are looking in the wrong direction.

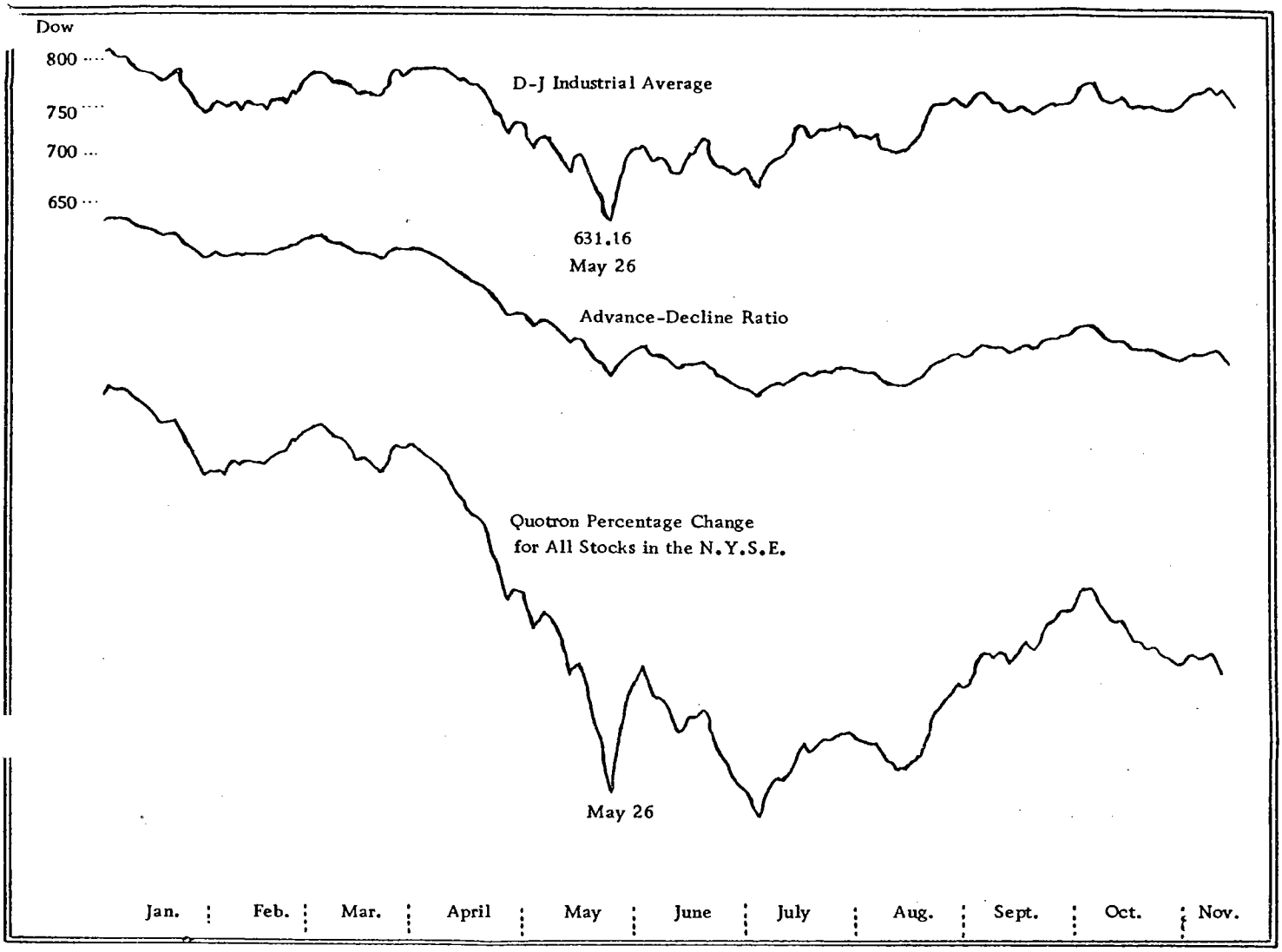
At the same time, manufacturers' plant capacity continues to increase while they use that capacity less and less. This spells the end of the capital goods boom, and indeed on November 6 it was announced that capital spending plans for U.S. business calls for only a 2% increase in spending next year. My bet is that there will be an actual net reduction in capital spending during 1971.

Confirming this is the decline in orders for maching tools, from $901 million in April, 1969, to $740 million in April, 1970, to $578 million in September, 1970.

Unfilled orders have been steadily declining, from $89 million in April, 1969, to $82 million in April, 1970, to $79 million in September, 1970. Against this, inventories of goods have actually been climbing from $91 million in April, 1969, to $97 million in April, 1970, to $98.5 million in August, 1970. This is very serious. If unfilled orders continue receding there will be a massive inventory liquidation as manufacturers scramble to get their inventory in line with sales.

But perhaps the most crucial area of all is corporate profits. Earnings are the life blood of the American economy, and I have drawn attention to this serious situation in Letter after Letter, particularly in my chart of dividend action (see Letter 471). Dividend action is a reflection of current and prospective earnings. The October figures (in the next Letter) show that there were more dividend cuts and omissions and fewer dividend boosts than at any time in the last decade.

Eliot Janeway in his latest bulletin has seen fit to warn about the impending earnings collapse. He notes that although there is almost certain to be a spurt of business activity when the GM strike ends, there will be no spurt in earnings. Janeway comments towards the end of his report, "Up to the point at which the GM strike began to simulate the characteristics of a severe slump, the stock market seemed to be insured against another nose-dive by its inability to mount a climactic move into clearly top-half territory. But the literal collapse of the fourth quarter earnings base on which the rally has been built has yet to be grasped. By the time the news becomes official early in 1971, the market will be confronted with the harsh fact that earnings are not participating in the recovery in activity — which in any case will be short-lived....."



NEW INDEX: I have prepared a new chart (with the help of Mr. David Winthroath of San Diego) which traces the path of the D-J Industrial Average (daily closing), the Advance-decline ratio and the "Quotron price changes". The first two indices are well known to readers of these reports. The Quotron price changes are something new.

The Quotron price changes (shown in Barron's for each day of the preceding week) are the actual percentage changes of all stock listed on the N.Y.S.E. treated as a single equity. I have charted the Quotron changes on a continuing daily basis, which means adding or subtracting each days percentage change from the preceding. This Index provides an accurate look at the entire market from the standpoint of percentage change each day, just as if the whole N.Y.S.E. was a single issue.

Personally, I find this chart both fascinating and informative. In fact, I was quite surprised at what it showed when we completed it. For instance, the January high (the high for 1970) on the D-J Industrials was 811.31. Incidentally, it is "normal" or very common during major bear markets for the high of the year to appear during January or during the first quarter. This is because time works against stocks during a bear market, and as the year stretches out values deteriorate. At any rate, the most recent rally took the Dow back to the 770-780 level, only approximately 30 points from the January high.

From the shareholders standpoint, then, those who were lucky enough to hold only the Dow stocks saw their shares return almost to the January levels. The advance-decline ratio presents another story, however, as the A-D ratio is not a price index but an indicator of the advancing or declining tendencies of the majority of stocks, it can not be compared with the Dow in a price sense. From an advance-decline standpoint, however, it is clear that the majority of issues have not kept up with the Dow. Note on the most recent rally, that the A-D ratio has failed singularly to confirm. At its November peak level, the A-D ratio returned only to its early June area.

At the bottom of the chart we have the Quotron changes. Although the scale here is about double the scale of the other two (in order to show movement), it is clear that the level of the quotron as this is written is far, far below the comparable level of the Dow. Furthermore, the most recent rally (from the October low) failed to lift the Quotron near its September peak, which is a far poorer performance than the Dow.

On November 13, following a sharp two-day drop, the Quotron broke its October low to close at its lowest level since early September. Tracing back, it is also extremely significant that at the November 13 closing the Quotron was back to the peak level established by the very first rally from May 26 low. In other words, as of November 13, the Quotron Index showed no net gain beyond the May, 1970, peak. Six months of churning and bullish propaganda — with no net gain!

This laggard performance on the part of the Quotron explains why investors and the public are not excited about this market. The fact is that despite the good rally in the Dow, the mass of stocks are not performing well and the stockholders of early 1970 have not even begun to get even. Thus, the bear market is playing its little game of "frustration." Let the Dow rally, but let the rest of the Board languish. For while the Dow plows around the 770-790 level, the great majority of issues on the N.Y.S.E. have refused to enter into the upside-percentage effort. Unless the Quotron figures move much, much higher, you can take it for granted that the majority of the stocks are still showing major losses for 1970.

EX-PRESIDENT ACTS: I am indebted to a Pasadena subscriber for sending the Page 6 article from the Nov. 1 Los Angeles Times. I consider the article so interesting that I am reprinting it as it appeared. Two comments: (1) It is not what a man says, it is what he does that counts in markets. (2) I can't guarantee it, but millionaire ex-Presidents probably have excellent sources of information and very good business sense.

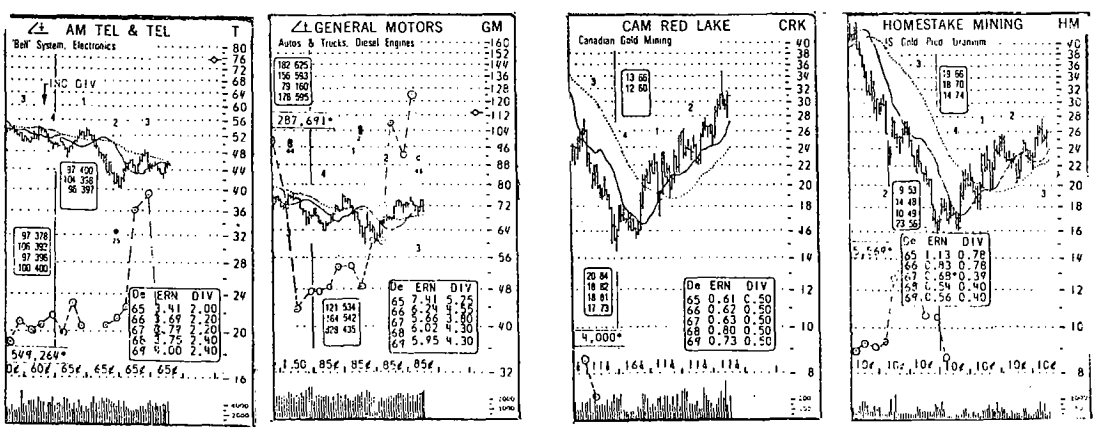
NOTES: This might be a good time to repeat again that (with apologies) I cannot answer most of the letters received here. It takes a good deal of time to answer a letter, and it takes a lot of energy to figure out answers (assuming I can come up with them). I do not offer a personalized investment advisory service, but on the other hand every word which appears in Dow Theory Letters is written by me.

I want to thank the many, many subscribers who send me articles and notes and analyses of interest. I find such items invaluable, and it means that I can write these Letters with the aid of thousands of trained "eyes". To all those helpful subscribers I offer my thanks, and I am sure I am safe when I say that I can offer the thanks of all the other subscribers as well.

One question which comes up constantly is, "When are you going to suggest stocks again". More recent subscribers ask, "Do you ever recommend stocks for purchase?" The answer is, yes, I do, and I will again. My thesis is that one loads up with stocks at the beginning of a primary bull market, and one cleans out at the end of a bull market. And when I say "clean out" I also mean "stay out." I have consistently advocated staying out of this primary bear market (except for gold shares), and I will adhere to that policy for the rest of this second phase of the bear market and through what I believe will be a disastrous third phase. I do not know whether the wind-up of the second and the conclusion of the third phases will take another year or another two years or more. I only interpret and follow the market, I don't make the market. Therefore, our difficult policy will be to stay out.

When the bottom arrives, when high-grade and growth stocks provide amazing yields, when the bear is exhausted, when the dust settles, when the gloom is so thick you can cut it with a knife, when everyone tells me "The nation will never again recover," then we will start loading up with stocks in preparation for a new primary bull market. Yes, I will be recommending stocks right and left. But I want my subscribers to be in shape to act on that advice, and that means weathering the bear market. I know there are only a handful of men in the country writing this way, but I'm used to that. When everybody thinks the same watch out — nobody's thinking

STORY IN PICTURES: (charts courtesy of Quote Digest, 403 N. Main, Wichita, Kansas 67202). Shown here are weekly charts of two of America's top corporate giants, and two listed gold stocks. The full story is yet to come.



Johnson Surprises Neighbors; Sells Bank for $2.7 Million

BY NICHOLAS C. CHRISS
Times Staff Writer

JOHNSON CITY, Tex.—When Bill Noble sat down for breakfast with Lyndon B. Johnson a short time ago at the former President's Pedernales ranch, it was to discuss acquiring a ranch Mr. Johnson had put up for sale.

Noble eventually ended up not only with the ranch but also with the Johnson City Bank.

And Mr. Johnson ended up with about $2.7 million, according to the best estimates of some of his closest friends and banking associates, plus about $250,000 for his ranch.

The sale of the bank to an "outsider" caught some of Mr. Johnson's friends and neighbors by surprise, including bank President M. C. Winter who organized it with 30 Johnson City residents in 1944.

Noble owns two banks in Victoria and Sinton, Tex. — small banks he has built up to deposits totaling almost $50 million.

"Somehow we got to talking about banks," Noble recalled. "I had just been looking for a ranch in the Hill country, so help me, Mr. Johnson said he had an appointment but when we started talking about the bank he forgot his appointment and took me down to see it."

The bank sale was concluded last week, and its approximate price for three times book value was confirmed by several knowledgeable banking sources as well as by officers in the bank.

As country banks go, the Johnson City Bank is a gem, they agree. But it has peaked, and Noble said Mr. Johnson sold it to place the bank in more aggressive hands and to help Johnson City's sagging economy.

However, Mr. Johnson has also sold a second ranch and has put two more up for sale—all very quietly. Some close friends believe he is liquidating his Hill Country assets because his two sons-in-law Pat Nugent and Charles Robb—have no interest in banking or ranching.

Another theory held by banker Winter, one of Mr. Johnson's closest longtime friends, is that the ex-President believes hard times are around the corner.

Winter himself has sold a 3,500-acre ranch for over a million dollars and is selling several million dollars worth of heavy machinery from his large road construction firm.

The bank is the keystone of the Johnson family's Hill Country fortune. At the time of the sale it had $1.5 million in cash, $2 million in government security but only $500,000 in loans. Its shares were worth about $900 apiece and it was capitalized at $900,000.

"Mr. Johnson is interested in doing something for Johnson City's economy," Noble said. "But because of his age he wanted to divest himself of the bank."

When Winter formed the bank it was capitalized at about $30,000. He said the former President mentioned to him a number of times that he would like to sell his other interests.

Other Rich Interests

These include controlling interest in several Austin banks, a bank at Llano as well as the flagship of the Johnson family wealth, the multimillion-dollar broadcasting properties in Austin. Nugent worked as a vice president of the broadcasting business, and lives in Austin. But he resigned and now commutes 77 miles one way to San Antonio daily where he works for an athletic goods firm.

"I think he (the former President) just wants to get out," Winter said. "The time is right; prices are high for land (about $300 an acre). He can just take his money and split it for the girls when the time comes."

But Winter said also Mr. Johnson probably is liquidating because he believes hard times may be coming.

"Every time he came back from Washington to Johnson City, he used to tell us, 'Boys, liquidate everything you got,'" Winter said.

Big Asking Price

Winter and a few others are peeved about the sale of the bank to an outside group. Within a very small and tight coterie of Mr. Johnson's friends, it was known that he wanted to sell the bank. Winter said, "He offered it to me once a month for 12 months but he wanted three times book value and I thought that was too high."

(Most banking sources agreed, however, that the sale of the bank for three times book value, or three times its capitalization of $900,000, was not unusual.)

But Mr. Johnson's quiet financial transactions have caused widespread consternation in the Hill Country.

"They don't call this territory LBJ country just because he lives here," said one resident. "It's also because LBJ owns so much of it."

Thus, when Mr. Johnson sells his bank and a ranch, and then another ranch, and puts two more up for sale—as he has recently—there is a good bit of speculation about his motives. The two ranches he has sold total about 2,000 acres.

"That bunch (Mr. Johnson and associates) would sell anything for a profit," said one county official in the courthouse across the street from the bank.

"The bank used to be locally owned," he added bitterly.

Mr. Johnson became a stockholder in the bank in 1949 when he purchased 10 shares, according to county tax records.

Bought More

In 1952 he upped his portion to 100 shares, and some of his associates also began buying shares.

By 1958, Mr. Johnson owned 430 shares and there were more business associates listed as shareholders and fewer local residents. The bank then was capitalized at $780,000.

In 1962 Mr. Johnson no longer was listed as a shareholder. But his Brazos-Tenth Street Corp. owned 618 shares. By 1964 these had increased to 1,664 shares. Last week when it was sold Brazos owned 1,774 shares. Twelve other stockholders owned 224 shares—none of them original stockholders aside from Winter, who owned 10 shares.

"He kept wanting to buy our shares 'til we got tired of it and we kept selling them to him," Winter said in an interview. "We thought he wanted the bank for a long-term family investment. I wouldn't have sold them if I knew he was going to start liquidating."

Winter said the bank has done practically no business for the past year.

"That's not a bank any more, it's a federal depository. We've lost business," Winter said.

"Now he tells me he wants to sell other interests—the bank shares in Austin and a radio and television station. I guess he just wants out of everything. He doesn't have anyone to pass it on to."

Other Theories

In contrast to theories that Mr. Johnson sees hard economic times around the corner for the country, Noble said the former President told him he wants to see an aggressive bank do things for his home county.

Just before he left office, Mr. Johnson managed to provide federal funds for a 30-bed hospital in Johnson City. It has, at times, been without a doctor. The city also received a new federal building but, as Holton Burleson, the sheriff and tax assessor, said: "We're not exactly going backward, but we're not going forward either."

One of the first things Mr. Johnson said the night he returned from Washington was that he wanted to see the Hill Country improve economically. But sheep and cattle ranching, its main asset, have fallen upon hard times.

Noble predicted a rosy future for the county. He said he has added another $1 million in deposits to the Johnson City Bank, and together with his two other banks he now has a loan capacity of $750,000.

He said the ex-President insisted that a young man, not older than 28, be hired to run the bank on a day-to-day basis. Noble hired his 26-year-old nephew, a Houston banker, to do the job.

He admits the Johnson City Bank held some surprises for him. The top floor of the small two-story building consists of three apartments Mr. Johnson built for overflow guests from his ranch. The basement is a large office for the President.

Noble and his team of men from Victoria also offer a contrast in the quiet clannish little town. Noble has a sort of wheeler-dealer image to local inhabitants, and he has long hair that curls in the back, a mini-Fu Manchu mustache and wears mile-wide neckties. He said he recognizes that Johnson City residents may look askance at an outsider.

One of the banks new officers said the bank maintained an antiquated bookkeeping system and kept many of its records and official documents in 30 to 40 fishing tackle boxes on the floor near a safe.

As for Mr. Johnson, he has nothing to say about his recent transactions.

His press secretary, asked for some comment about them, replied: "You'll have to ask his business agent."

Who's that?

"Lyndon Johnson."